

Office of City Auditor

Transportation Expenditures: Compliance And Controls Are Good But Can Be Improved

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Executive Summary

In response to the City Council's request, the Office of City Auditor performed an audit of the Seattle Engineering Department's Transportation Division. For the purposes of this report, we specifically reviewed the Transportation Division's financial systems to determine whether the Division (1) is complying with regulatory and expenditure restrictions over Local Option revenues and Motor Vehicle Fuel Tax (Gas Tax) revenues and (2) has adequate management controls to ensure it collects and spends its funds appropriately. We describe our findings with regard to the Transportation Division's budgetary and planning controls in a separate report, Transportation Financial Management: Revenue Forecasting and Expenditure Management Are Improving, released in November 1996.

Results of Our Work

Overall, the Transportation Division spends Local Option and Gas Tax revenues in compliance with applicable laws and regulations and is accurately reporting these expenditures. Our review of the Transportation Division's compliance with applicable laws and regulations, found two minor types of discrepancies:

- The City was not meeting one of the State's documentation requirements on the use of Local Option revenues. Specifically, the City is required to identify the operational costs it plans to pay from these revenues. However, the City did document its plans for capital expenditures in the Transportation Capital Improvement Program, where it has spent the bulk of Local Option revenues.
- Of the 164 projects for which the City used restricted Gas Tax funding, four projects did not meet the requirements for such funding. However, the \$602,000 of incorrect expenditures could have been paid from less restricted Vehicle License Fee funds. The incorrect charges represent 1.8 percent of the \$34.4 million budget for planned expenditures of Gas Tax funding which we reviewed.

The Transportation Division generally has good internal controls over its major financial processes but could strengthen its internal controls to improve the timeliness and accuracy of its billings to granting agencies. Specifically, we found one project for which the Grants Receivable Section had not yet submitted a final bill totaling \$55,000, even though 14 months had passed since it received notification to do so. Transportation Division officials agreed that in the past projects were not closed in a timely manner.

During our review, we identified several ways the Transportation Division could improve its processes. The Transportation Division has agreed with our recommendations and has implemented or is in the process of implementing them, including

- preparing a resolution on Vehicle License Fee use for passage with the 1997-98 biennial budget which specifies the operational costs to be paid from Vehicle License Fee revenues and the locations at which these costs will be incurred;
- reviewing and changing its expenditure practices to ensure that it spends money from the Arterial City Street Subfund only for projects which meet the State's expenditure restrictions; and
- sending granting agencies a project's final billing in a timely manner.

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PURPOSE

In response to the City Council's request, the Office of City Auditor performed an audit of the Seattle Engineering Department's Transportation Division. For the purposes of this report, we specifically reviewed the Transportation Division's financial systems to determine whether the Division (1) is complying with regulatory and expenditure restrictions over Local Option revenues and Motor Vehicle Fuel Tax (Gas Tax) revenues and (2) has adequate management controls over its process to ensure it collects and spends its funds appropriately. We describe our findings with regard to the Transportation Division's budgetary and planning controls in a separate report, Transportation Financial Management: Revenue Forecasting and Expenditure Management Are Improving, released in November 1996.

BACKGROUND

The Transportation Division is one of four line divisions of the Seattle Engineering Department. It maintains and operates the streets, structures (such as bridges), and traffic control systems in Seattle and had a 1995 budget of approximately \$45.5 million. Of this amount, about 21 percent is funded from the City's general revenue sources. The remaining 79 percent comes from special revenue sources such as state and federal grant funds, the state Motor Vehicle Fuel Tax (Gas Tax) and Local Option¹ revenue sources. At present the City's only Local Option revenue source is its vehicle license fee; from 1993 to 1995 the City also collected street utility fees.

The Transportation Division may spend most outside revenues simply for "transportation purposes" -- any activity which is reasonably related to transportation. Some of these revenue sources impose special restrictions on their use, however. For example, the Division may use certain Gas Tax monies only for capital expenditures to repair, improve or construct roadways. Likewise, most state and federal grants, which Transportation has been quite successful in obtaining, apply only to capital projects, not to maintenance or operational activities. According to Transportation Division staff, these grants reimburse the City for roughly 65 percent of project costs.

The Transportation Division uses the City's computerized accounting system, the Seattle Financial Management System, to track expenditures. The system uses project work orders to charge expenses to specific funds. When more than one funding source is paying for a project, the system applies a billing agreement to allocate the expenses among the funds.

¹ State law allows local jurisdictions to collect special revenues on a local basis for Transportation funding purposes. These revenues include a fee for licensing vehicles, user fees to support a street utility, and a local gas tax. Since local jurisdictions can choose whether or not to collect these revenues, they are known as "Local Option" revenues.

SCOPE AND METHODOLOGY

We were requested to review the Local Option revenues (Street Utility and Vehicle License Fee) to determine whether the Transportation Division was complying with regulatory restrictions on expenditures. We also reviewed the Arterial City Street portion of the Gas Tax because it funds capital projects.

To determine whether the Transportation Division has adequate internal controls over its revenues and expenditures, we first performed a risk assessment on the Transportation Division's major financial processes. Specifically, we reviewed grant development, project design, labor and overhead, equipment, miscellaneous purchases (supplies), contracts, consultant contracts and grant reimbursement. Our intent was to focus our intensive review on areas with high potential for errors and high financial and monetary risk to the City.

Based on this assessment, we focused our work on the grant reimbursement process to determine whether the Transportation Division was billing granting agencies for all allowable costs and whether the Division was paying contractors only for work they had completed. Working jointly with the Transportation Division, we identified 14 projects that were closed or had reached the total reimbursable amount in 1995.² From the 14 projects, we judgmentally selected 5 capital improvement projects for review: Dust Control Paving, Fairview Avenue North, Fauntleroy Way Southwest, James Street, and North 85th Street. These five projects represent roughly 41 percent of the expenditures for the 14 projects (\$5.6 million of \$13.6 million). Two of the five projects began before 1991, and two began between 1991 and 1993. We selected the last project as an example of an on-going project which had reached the total amount reimbursable.

In performing this review, we

- interviewed State officials and Transportation Division and Engineering Services Division management and staff; and
- reviewed Transportation Division policies and procedures and other pertinent documents and reports.

To determine whether the Transportation Division was complying with the expenditure restrictions, we

- reviewed the planning and budgeting requirements for each funding source and the City's practice in complying with these requirements;
- downloaded all of the Transportation Division's billing

² Since the Transportation Division does not maintain a list of completed projects, we had to go through all the project files to determine (1) whether or not the project was completed or the maximum reimbursable amount had been reached and (2) how much was spent on the project.

agreements from the City's financial system;

- reviewed the titles of the Transportation Division's billing agreements for any indication of projects which did not meet the funding restrictions, discussing some with Transportation Division officials; and
- judgmentally sampled 30 journal entries (12 of them manual) which removed funds from the subfunds.

In performing our risk assessment of internal controls, we reviewed policies and procedures, conducted walk-throughs of the process and observed individuals conducting their work.

Our detailed review of internal controls over grant monies included the following:

- comparing billing invoices to expenditure documents to determine whether the Transportation Division had billed all allowable expenses;
- verifying that the granting agency had reimbursed the City for all allowable expenditures;
- reviewing contractor progress payment reports to verify that the City had paid contractors only for the work they had done and that the City had withheld appropriate retainage from their payments;
- identifying how long the Grants Receivable Section took to bill the granting agency for final payment after receiving notification of project completion; and
- reviewing capital improvement project files, including state and federal funding agreements, billing invoices, and supporting accounting documents.

We conducted our field work in accordance with generally accepted governmental auditing standards.

RESULTS OF OUR WORK

The Transportation Division Is Generally Complying with Local Option and Restricted Gas Tax Revenue Requirements

The Transportation Division has generally complied with applicable laws and regulations in expending Local Option and restricted Gas Tax revenues and has accurately reported these expenditures. Specific minor improvements are listed in the following sections.

The Transportation Division Generally Complies with Local Option Revenue Restrictions

During our review, we found the Transportation Division complied with the State's requirements for collection and expenditure of Local Option (Street Utility and Vehicle License Fee) revenues. Specifically, the Transportation Division complied with the following requirements:

- spending funds for transportation consistent with adopted transportation and land use plans;
- coordinating the City's transportation plan with other jurisdictions; and
- maintaining a six-year funding plan which is updated annually and identifies specific public and private sources and the amounts of revenue necessary to fund the plan.

In addition, during our testing of whether the Transportation Division was complying with expenditure restrictions, we did not find any indications that the Division had spent these Local Option revenues inappropriately.

Compliance with Local Option Revenue Requirements

The Transportation Division does not fully comply with State law, which requires the City to identify all uses of Local Option revenues. The RCW 82.80.070(3)(b) requires the City to develop and adopt a specific transportation program that is

...based on an adopted transportation plan for the geographic areas covered and shall identify the proposed operation and construction of transportation improvements and services in the designated plan area intended to be funded in whole or in part by local option transportation revenues and shall identify the annual costs applicable to the program.

The Transportation Division does identify Local Option revenues appropriated for capital construction projects in the Transportation Capital Improvement Plan. However, it does not identify operational costs paid by Local Option revenues in an adopted budget or planning document. Specifically, the Transportation Division expended Vehicle License revenues to pay for residential parking zone administration costs. To correct this oversight, the

Transportation Division is preparing a resolution on Vehicle License Fee use for passage with the 1997-98 biennial budget. This resolution will specify operational costs to be paid from Vehicle License Fee revenues and the locations at which these costs will be incurred. The City satisfies all other restrictions which the State has placed on the use of Local Option revenues.

Restricted Gas Tax Expenditures

Of the 164 projects for which the City used restricted Gas Tax funding, four projects did not meet the requirements for such funding. The Arterial City Street Subfund receives money from restricted Gas Tax revenues, and State law³ requires that the City use these funds exclusively for repair, improvement and construction of City's highways and streets. Instead, the Transportation Division used the funds for publishing a map of bike routes in Seattle; administering residential parking zones; making a pedestrian access video; and managing the ride share carpooling program, none of which met the State requirements. The expenditures for these four projects totaled approximately \$602,000 or 1.8 percent of the more than \$34.4 million budgeted for the 164 projects.

At the same time, we identified at least 12 projects totaling over \$1.9 million in the Vehicle License Fee Subfund alone that would have qualified for the more restricted Arterial City Street Subfund funding. To comply with State restrictions, the Transportation Division could have funded some of these programs from the more restricted Arterial City Street Subfund and funded the four programs cited above from the less restricted Vehicle License Fee Subfund.

The Transportation Division has agreed with this finding and, effective with its 1997-1998 budget, has taken steps to ensure that it spends money from the Arterial City Street Subfund only for projects which meet the State's expenditure restrictions.

The Transportation Division Could Strengthen Its Management Controls Over Grant Billings

The Transportation Division appears to have good internal controls over the major processes we reviewed. It can make some improvements in the process it uses to bill agencies for grant funds to ensure timely billings.

³RCW 46.68.115

***The Transportation Division
Generally Has Good Internal
Controls Over Major Processes***

During our risk assessment of the Transportation Division, our review of policies and procedures and our walk-throughs and observations of individuals at work indicated that the Division had good internal controls over most major processes. In our risk assessment, we focused particularly on the processes associated with grant development, project design, labor and overhead, equipment, miscellaneous purchases (supplies), construction contracts, and consultant contracts. We did not review project management, which is primarily conducted by the Engineering Services Division (another division within the Engineering Department). In a more detailed review of the grant-reimbursement process, we also generally found good internal controls, including

- posting of payments to the appropriate accounts and verifying them through reconciliation of the grants receivable;
- appropriately segregating duties for invoicing, receiving and posting payments;
- withholding appropriate retainage from contractor's periodic payments; and
- paying of contractors only for work completed.

***Transportation Needs to Ensure
Its Bills to Granting Agencies
Are More Timely***

In our review, we found examples of delayed billings to State agencies which provide state and federal grant funds. In examining five projects for which the City had either completed the work or exhausted the grant funds, we found one project still needed to bill for \$55,000. Our examination of this project occurred 14 months after the Grants Receivable Section received notification from the Finance Analyst to send the final bill. The Grants Receivable Section recently sent the final bill in July 1996 after we inquired why the final billing had not yet gone out. Transportation Division officials agreed that projects were not closed in a timely manner.

The Transportation Division is presently reviewing its billing processes to ensure it bills granting agencies in a timely manner. The Division also plans to develop automated spreadsheets to identify whether it has billed all allowable costs.

FUTURE CONSIDERATIONS

When the City was collecting commercial Street Utility fees, the Transportation Division did not have an adequate accounts receivable system to monitor its collections.⁴ The system for billing businesses for commercial Street Utility fees included approximately 40,000 accounts. Transportation staff could manually identify individual account balances; however, the system could not provide a list of the accounts which had not paid the tax. The system could provide only a lump sum total of how much was still owed. As a result, the Division could not reconcile individual accounts with the amounts collected and the amounts still outstanding. Last year, the Washington State Supreme Court ruled the residential Street Utility fee was an unconstitutional property tax. As a result, the City voluntarily suspended its commercial Street Utility fee, which generated about \$5.5 million annually. If the City reinstates this fee or some other transportation fee where payments are received from individual accounts, the Transportation Division should improve its accounts-receivable system to provide an automated listing of past-due accounts.

THE TRANSPORTATION DIVISION'S ACTION PLAN

During our review, we identified several ways the Transportation Division could improve its processes. The Transportation Division has agreed with the recommendations we made during the course of this review. Specifically, the Transportation Division

- has prepared a resolution on Vehicle License Fee funding for passage with the 1997-98 biennial budget which specifies the operational costs to be paid from Vehicle License Fee revenues and the locations at which these costs will be incurred;
- has reviewed and changed its expenditure practices to ensure that it spends money from the Arterial City Street Subfund only for projects which meet the State's expenditure restrictions; and
- will send granting agencies a project's final bill in a timely manner after it receives notification from the project manager that the Division has completed the project.

⁴Due to cost considerations, the City did not purchase an accounts-receivable module with its present computerized accounting system. As a result each department must design and obtain its own system for accounts receivable.

Seattle Engineering Department's Response to Our Audit Report

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